CASE NO. PUE900023
OCTOBER 19, 1992

APPLICATION OF
VIRGINIA ELECTRIC AND POWER COMPANY

For an expedited increase in rates

DISMISSAL ORDER

By order dated June 2, 1992, the Commission required Virginia Electric and Power Company ("Virginia Power" or "Company") to refund excessive rates together with interest and to file a document on or before October 1, 1992, showing that all refunds had been lawfully made. This matter was continued until further order of the Commission.

On September 30, 1992, counsel for Virginia Power submitted a statement of compliance signed by the Company's Senior Vice President - Finance and Controller that all refunds had been made pursuant to the Commission's order of June 2, 1992. Also attached was an itemization of the Company's actual cost of the refund through August, 1992, and estimated cost for the month of September, 1992.

With the refunds having been accomplished, the Commission of the opinion that nothing further remains to be done in this case. Accordingly,

IT IS THEREFORE ORDERED that this matter is dismissed and the record developed herein shall be placed in the file for ended causes.

Commissioner Moore took no part in the consideration of this matter.

CASE NO. PUE900070
MARCH 27, 1992

COMMONWEALTH OF VIRGINIA
At the relation of the
STATE CORPORATION COMMISSION

Ex Parte: In re, Investigation of Conservation and Load Management Programs

FINAL ORDER

By order of January 7, 1991, the Commission initiated an investigation to consider the subject of conservation and load management ("CLM") programs of electric and gas utilities. We noted therein that we have long encouraged utility efforts to promote CLM. However, we recognized that our policies have generally been developed on a case by case basis in reviewing tariff provisions, experimental CLM programs, ratemaking treatment for companies' CLM efforts, and advertising expenses and promotional practices (See Comm. of Va., at the relation of the S.C.C., Ex Parte: In Re, Investigation of Promotional Allowances, 1970 S.C.C. Ann. Rept. 136, Case No. 18796, Final Order, April 15, 1970). We therefore determined that it was now appropriate to address CLM in a more comprehensive manner. We requested comments on a broad spectrum of such issues, to be filed no later than February 28, 1991. Staff was directed to review those comments and prepare a report recommending specific rules or policies regarding CLM programs on or before April 26, 1991. Thereafter, the Commission invited a second round of comments on the Staff Report. Finally, we heard oral argument on October 29, 1991.

The response to our order was substantial. Almost 300 interested parties filed comments. Many of those were individual citizens who unanimously applauded CLM efforts. Companies, government agencies, nonprofit organizations, and citizen and environmental groups also responded. Utilities participating included Virginia Electric & Power Company ("Virginia Power"); Appalachian Power Company ("APCO"); The Potomac Edison Company ("Potomac Edison"); Kentucky Utilities d/b/a Old Dominion Power Company; Delmarva Power & Light Company ("Delmarva"); the Virginia, Maryland and Delaware Association of Electric Cooperatives ("the Cooperatives"); Commonwealth Gas Services, Inc. ("Commonwealth Gas"); Virginia Natural Gas, Inc. ("VNG"); United Cities Gas Company; and Washington Gas Light Company ("WGL"). Government agencies and other organizations filing comments included the Environmental Protection Agency ("EPA"); Elizabeth Haskell, Secretary of Natural Resources, Commonwealth of Virginia ("Secretary Haskell"); The Department of Mines, Minerals and Energy, Commonwealth of Virginia ("DMME"); Division of Consumer Counsel, Office of the Attorney General, Commonwealth of Virginia ("Consumer Counsel"); Transphase System, Inc.; Sycom Enterprises; Virginia Committee for Fair Utility Rates ("the Committee"); Southern Environmental Law Center ("SELC"); Conservation Council of Virginia; the Virginia Chapter of the Sierra Club; Natural Resources Defense Council ("NRDC"); Fairfax County Department of Consumer Affairs; Virginia Citizens Action ("VCA"); and the American Lung Association of Virginia.

STAFF RECOMMENDATIONS

The Staff report summarized existing CLM efforts in Virginia and the nation, provided an overview of existing Commission policy regarding CLM programs, suggested certain policy modifications, and discussed key issues which should be addressed in this proceeding.

First, the Staff recommended that the rules relating to promotional allowances be revised so as to permit such allowances for cost effective CLM programs. It distinguished such programs from those designed primarily to increase load or market share, and recommended, as a prerequisite to rate recovery of related costs, that all programs be evaluated and approved on a case by case basis to assure that a program is both cost effective and primarily directed at CLM, rather than some other objective.

A pivotal policy question identified by Staff was that of measuring the cost effectiveness of CLM programs. The criteria used to quantify costs and benefits, and thereby evaluate effectiveness, is clearly crucial to the determination of public interest. It was Staff's opinion that this issue requires more detailed work before a recommendation can be made to the Commission, and that a series of technical conferences or a task force should thus be organized. Such an effort would provide a focused and in-depth analysis of various evaluation methods.

The report also addressed the extent to which environmental and societal externalities should be considered in the evaluation of program costs and benefits, noting that this is "the most controversial issue in this proceeding." In question are those environmental and societal costs and benefits which are not currently internalized by utilities or explicitly quantified in the planning process. Staff said that any attempt to internalize such costs or benefits could have far reaching implications. It therefore suggested that new legislation might be a more appropriate vehicle to initiate such a change.

Once utilities implement optimal CLM programs, the focus will necessarily shift to recovery of costs. The Staff discussed two aspects of this issue: direct CLM program costs, and "lost revenues." Staff observed that currently most direct costs are expensed in the year they are incurred; however, other options are available and should be considered. For instance, some costs can be capitalized in rate base when programs have long term benefits. Staff felt that specific cost treatment should be addressed in individual rate cases, given the potentially wide disparity among programs of various companies. Automatic adjustment clauses should not be used for such recovery, in Staff's view, since the Commission's general policy regarding the use of such a clause is only to "allow a utility to adjust, without a rate increase, its revenues in response to changes in the costs of a relatively volatile, major expense item . . . over which it has no control." App. of Old Dominion P. Co., 1984 S.C.C. Ann. Rept. 408, aff'd, Old Dominion P. Co. v. S.C.C., 228 Va. 528 (1984).

In regard to "lost revenue", the Staff noted that, since sales and profits are closely linked under current ratemaking principles, by promoting conservation a utility may forgo some profits due to lower sales. The parties expressed divergent views on whether such "lost revenues" should be accounted for in setting rates. Although Staff identified a variety of approaches for addressing the issue, it made no recommendation. It did believe utilities should be allowed to propose and attempt to justify lost revenue recovery methods in rate cases.

Several parties had addressed the role demand-side bidding might play in a utility's resource plan, and the potential benefits of injecting a market place pricing discipline into utility planning. One of the difficulties associated with demand-side bidding, however, is the measurement of the results of third party programs, to assure that projected savings are achieved. A related question is whether third party CLM programs will materialize and perform as promised over the long term. Because of such uncertainties, Staff did not suggest utilities be required to use bidding. It believed, however, that the potential benefits warranted examination, and it recommended that Virginia Power be directed to use a demand-side bidding program on an experimental basis, since that company has had extensive experience with supply-side bidding for nonutility generation over the last four years.

Staff also suggested that any proposed demand-side bidding programs should be considered in formal Commission proceedings, to foster a comprehensive review of a utility's integrated resource programs, plans for implementation, and cost/benefit analysis.

In oral argument, Staff said that consideration of demand-side options must necessarily include study of supply-side options, as well, and it suggested it may be time to implement formal review of utility companies' entire integrated resource plans.

Numerous parties filed comments on the Staff Report: Consumer Counsel, Secretary Haskell, DMME, APCO, Potomac Edison, Delmarva, Virginia Power, Commonwealth Gas, WGL, VNG, the Cooperatives, the Committee, Arlington County, VCA, NRDC, SELC, and the Virginia Chapter of the Sierra Club. At the hearing, statements were received from Staff; State Senator Robert C. Scott; Secretary Haskell; EPA; NRDC; SELC; the Virginia Chapter of the Sierra Club; the Conservation Council of Virginia; Sycom; Elizabeth Ising; William B. Charlton; VCA; the Consumer Counsel; Thomas J. Charlton; the Committee; the Cooperatives; Potomac Edison; Virginia Power; Commonwealth Gas; and WGL and Shenandoah Gas Company.

Although we will not summarize all comments of all parties received in this proceeding, the Commission found such extensive input quite valuable in reaching its decision herein.

PARTICIPANTS' COMMENTS

Senator Scott urged the Commission to establish rules that would require electric utilities to meet as much need as possible through energy conservation. He recommended that environmental and social externalities should be considered. He also supported the Staff recommendations to remove prohibitions on promotional allowances, and to place demand and supply-side options on par. In addition, he suggested the Commission consider the potentially favorable impact certain rate structure innovations, such as the use of inclining block rates (under which the price per unit increases with higher usage), might have on CLM.

Secretary Haskell strongly supported energy conservation, noting that Governor Wilder has issued a state energy plan which emphasizes this point. She urged the Commission to encourage innovation to improve environmental quality in Virginia, and to remove regulatory and market barriers to energy conservation measures. She applauded liberalized promotional allowances as a good first step. She believed the Commission should equate demand and supply-side options and should consider environmental externalities in evaluating utility resource plans. Her final recommendation was that the Commission initiate a task force to address the many details associated with integrated resource planning. She observed that the bonus allowances available under the Clean Air Act clearly provide an economic incentive for Virginia to promote energy conservation.

The Consumer Counsel agreed with the Staff's recommendation that the costs associated with CLM programs should be treated in a comparable manner to those of supply-side options. He reviewed the concerns which gave rise to the present ban on subsidies and promotional

allowances and urged that any revision to those rules respect those concerns. He expressed misgivings that some programs may result in building market share rather than decreasing loads, and approved the Staff's suggestion to limit proposals to CLM initiatives. Counsel urged the Commission not to take any action to reimburse utilities for "lost revenues." Whatever revenue impacts occur, he argued, will be short term, because the test year revenue level under the normal ratemaking process will already reflect lost revenues.

The EPA encouraged the Commission to evaluate demand and supply-side options on an equal basis. It favored incentives to save, rather than sell, electricity.

The NRDC urged the Commission to authorize the decoupling of utility net profits from sales volume, as has been done in several states. It also encouraged positive incentives for energy efficiency performance.

The SELC, the Virginia Chapter of the Sierra Club and the Conservation Council of Virginia urged Virginia to declare a clear preference for utilizing cost effective conservation and efficiency measures as resources to meet the state's growing need for energy. They asserted that the cost effectiveness of CLM programs should be determined by comparing costs and benefits using the societal impact or "all rate payers" test. They urged the Commission to move forward to provide firm and aggressive guidelines promoting the development of demand-side programs that capture all cost aspects of conservation and efficient resources.

The Committee urged the Commission to proceed carefully, and to encourage innovation and promote cost effective programs, while bearing in mind the potential impact of significant changes in the ways utilities operate and the ways rates are set. It agreed that when CLM programs meet the utilities' needs and are more cost effective, they should be implemented instead of supply-side options, thereby resulting in the best mix of resources to meet the needs of customers at the lowest cost. The Committee opposed the concept of quantifying selected externalities. It argued that the suggestion to incorporate some externalities but ignore others could distort the balancing process, lead to economic inefficiency and result in higher utility rates. Further, it argued that the valuation of externalities is a nearly impossible task. It also agreed with the Consumer Counsel that the lost revenue issue need not be addressed, given the current ratemaking process.

The Cooperatives agreed with the Staff's proposed revision of the promotional allowance rules. They were concerned, however, with the related approval process and the potential for it to develop into protracted litigation, particularly related to alternative energy suppliers. They also endorsed the Commission Staff's position that quantification of externalities is more appropriately addressed by legislators than by the Commission.

Virginia Power believed that the Staff's proposed revisions to the rules for promotional allowances go a long way toward allowing the use of cost effective promotions as part of CLM programs. However, it urged the Commission to make clear that promotions which reduce unit cost of power, such as allowances for heat pumps, should also be allowed. Virginia Power stated that it was presently developing an internal methodology which would allow the company to give stronger consideration to many proposed CLM programs.

Commonwealth Gas Services urged further modification of the rules for promotional allowances to insure that no unfair competitive advantages are bestowed upon any utility in the name of CLM programs. It urged the Commission to consider source to site analyses, which it believed were necessary to validate claimed energy efficiencies.

WGL and Shenandoah Gas Company urged the adoption of a standard CLM cost benefit evaluation framework to be used by all utilities. They also proposed adoption of the "all rate payers test", which would consider the impact of a proposed program on all regulated energy suppliers, gas or electric. Finally, they urged funding limits for cooperative advertising by utilities.

<u>DISCUSSION</u>

We believe cost effective CLM programs are essential components of the balanced resource portfolio that utilities must achieve to provide energy to Virginia consumers at fair and reasonable rates. We appreciate the valuable input provided by the participants and our Staff in this investigation.

As we have considered the many issues here, it has become clear that a more detailed investigation will be needed regarding the appropriate tests to employ in measuring the success of programs. We must also continue to refine the distinctions between CLM programs on the one hand and on- and off-peak load building programs on the other. Specific ratemaking treatment of program costs will need to be evaluated carefully in the context of each utility's rate cases. This Commission, utilities, consumers and third-party CLM program providers must all continue to increase the public awareness of energy efficiency and conservation so that we may aggressively pursue implementation of sound cost effective programs.

While we are encouraged about the role conservation can play in our future, we must move cautiously in an attempt to avoid promoting uneconomic programs, or those that are primarily designed to promote growth of load or market share without serving the overall public interest. Conservation at any cost is not appropriate, and we must closely evaluate utility companies' demand-side programs to assure that each company is carefully following a cost effective strategy. Our goal then can be succinctly stated as establishing the framework which will facilitate <u>optimal</u> CLM programs. The Commission, in fact, has a statutory mandate to investigate the "acts, practices, rates or charges" of utilities to determine whether they are calculated to "promote the maximum effective conservation and use of energy and capital resources used by public utilities in rendering utility service" (Va. Code § 56-235.1).

The first critical question which we must address is which test or tests should be applied to judge whether a program is cost effective. Opinions on this issue varied widely among the participants in this proceeding.

We must adopt uniform measures against which to evaluate programs designed to conserve energy or better balance a utility's load. It is only with that information that we can determine if a program is in the public interest. We agree with our Staff, however, that the advantages and disadvantages of various assessment methods are not adequately developed in this record.

Staff suggested a task force or a series of technical conferences as suitable approaches to continue this investigation. Either method is acceptable. Staff should forthwith establish the necessary meeting schedules to collect the requisite data, followed by an interim report on or before

July 31, 1992, which will detail the procedures it will follow in its investigation, the goals of the process, any progress to date, and the date it expects to complete a final report. This final report should describe all alternative cost effective measures, the advantages and disadvantages of each, and Staff's recommendation on the appropriate tests to apply.

This effort should not involve the question of how to quantify environmental externalities, however. This Commission clearly considers environmental factors in rendering our decisions, but these factors are taken into account from a qualitative, not quantitative, standpoint. See Va. Code § 56-46.1. Under that statute, such factors are analyzed in rendering our decisions on whether to approve the construction of major electric transmission facilities. Similarly, we consider all aspects of the public convenience and necessity in deciding whether to approve certificates for the construction of other utility facilities. Moreover, to the extent those conditions impose direct costs on the public utility, they are reflected in rates, as appropriate.

However, we believe that we lack the statutory authority to go beyond this direct effect on the ratemaking process. Virginia Code § 56-235.1 commands us to determine which acts, practices, rates or charges are reasonably calculated to promote conservation and the maximum effective use of energy, but specifies "that nothing in this section shall be construed to authorize the adoption of any rate or charge which is clearly not cost-based or which is in the nature of a penalty for otherwise permissible use of utility services." Also, Virginia Code § 56-235.2 specifically states that the utility must demonstrate that its "rates, tolls, charges or schedules in the aggregate provide revenues not in excess of the aggregate actual costs incurred by the public utility in serving customers within the jurisdiction of the Commission," and prohibits speculative adjustments to such costs. We believe that it would be speculative, and thus contrary to our legal authority, to include adjustments in rates for external environmental factors. Moreover, as noted by the Committee, incorporating selected externalities, but ignoring the impact of others, could distort the balancing process and lead to economic inefficiency, resulting in higher utility rates for all customers. We therefore agree with our Staff and a number of the parties, who suggested that incorporation of environmental externalities should be dealt with from a broader perspective than utility ratemaking. Congress and the General Assembly are the proper bodies to provide this perspective. When and if we are directed by legislation to incorporate quantified environmental externalities into the regulatory process, we shall do so, of course.

The Staff did propose specific revisions to our current rules relating to promotional allowances, established by Final Order in Case No. 18796, dated April 15, 1970. Therein, we prohibited electric and gas utilities from giving any payment, subsidy or allowance to influence the installation, sale, purchase or use of any appliance or equipment. We were concerned with public service companies competing with independent contractors in the appliance market and further, with avoiding having such payments subsidized by all customers, specifically those not receiving the benefits of the promotional program. The situation has changed sufficiently to require us to revisit those rules and to consider the need to establish programs which will encourage sound CLM. The participants in this proceeding uniformly supported revisions to our 1970 rules.

We believe that promotional allowances for cost effective CLM programs are appropriate. Rate recovery for such promotions should be allowed only for cost effective CLM programs, though, and not for those designed primarily to increase load or market share, unless a company proves that the program is cost effective and serves the overall public interest. We will not expressly prohibit the payment of such allowances by utilities, however, but rather, we will only address the propriety of cost recovery through rates. We also caution that the rules do not guarantee rate recovery for cost effective CLM programs. The reasonableness of the level of costs incurred will be evaluated as a part of each company's rate case.

Advertising, and particularly cooperative advertising, was also addressed by Staff and the participants. The Virginia Code prohibits rate recovery for electric utilities for advertising unless it is required by "law or rule or regulation, or for advertisements which solely promote the public interest, conservation or more efficient use of energy . . ." Virginia Code § 56-235.2. Accordingly, the Commission has allowed reasonable levels of advertising expenses associated with CLM. Such practice will continue, but we will more closely scrutinize those costs in the context of individual rate cases, to carefully distinguish between advertising for cost effective CLM programs and those primarily designed to promote load growth which do not otherwise serve the overall public interest. State law does not currently address advertising by gas companies, but we have historically applied the same standards there.

WGL urged the Commission to impose funding limits on cooperative advertising. We agree that utilities should not be allowed to recover excessive levels of advertising costs. However, the proper level will vary widely from company to company depending on many individual factors. It is appropriate, then, to review the proper funding level for each company in individual rate cases.

Questions were also raised related to the ratemaking treatment for CLM program costs. Recovery of direct CLM program costs is currently addressed in each company's rate case. Most such costs are expensed, but some costs with long term benefits may be more appropriately capitalized and included in ratebase. We have stressed the importance of similar ratemaking treatment in the context of buy and build options.

Use of an automatic adjustment clause, however, is not appropriate. These clauses are permitted only in extraordinary circumstances "and with great caution, after carefully weighing the expected benefits against their disadvantages, in light of the public interest." Old Dominion P. Co. v. S.C.C., 228 Va. 528 (1984). Automatic adjustment clauses have been used to allow utilities to automatically adjust revenues to account for major, volatile costs beyond the company's control. At this time, the costs associated with CLM programs do not satisfy these criteria.

A number of participants also discussed alternative approaches to addressing "lost revenues", and this issue generated some controversy. If a conservation program is successful, utility sales should decrease and the company may forgo some profits until it can adjust its rates to reflect the decreased revenue. Staff identified some of the options other jurisdictions have implemented to deal with this subject. Staff made no specific recommendation, but suggested that the Commission consider proposals in the context of rate cases. Most utilities, not surprisingly, argued that an adjustment to compensate utilities for "lost revenues" is critical. Opponents countered that some regulatory lag exists with regard to all costs of service, and that the effect of CLM programs will be addressed in the normal course of ratemaking. We tend to agree. We should observe in this regard that we currently have a pending proceeding before us to revisit our utility rate case rules. In that case our Staff has proposed rules which provide a more forward looking test period. If such a concept is adopted, it may alleviate the problems associated with decreasing revenues resulting from aggressive conservation programs. We will, however, continue to monitor this phenomenon.

Rate design is also a powerful tool which can be used to achieve optimal CLM objectives. As Staff indicated, it is important to establish appropriate price signals to promote energy efficiency.

A large number of rate design objectives must be balanced in setting rates, and the Virginia Supreme Court has sustained the Commission's determination that "non-cost factors may be considered by the Commission in setting rates for various classes of services . . . to accomplish legitimate regulatory objectives." Secretary of Defense v. C & P Telephone, 217 Va. 149, 152 (1976).

Clearly then, we have the discretion to consider the impact of rate design on CLM. Rates can reflect costs or drive costs. Examples of the latter would include mandatory time of use rates and summer/winter differentials. In designing rates, utilities should consider costs and cost allocation in terms of the market signals sent by the rates. We thus encourage utilities to pursue innovative rate design and continue to improve costing methodologies.

Staff recommended that Virginia Power be required to implement a demand-side bidding program. There are clearly potential benefits which may flow from demand-side bidding programs similar to those we have seen from the supply-side resource selection process. Competition appears to have lowered costs, encouraged technical innovation and provided an independent check on utility cost estimates. There are also a number of potential difficulties unique to demand-side bidding, as noted in the record, however. Therefore, an experimental program such as that suggested by Staff, and which Virginia Power has endorsed, will provide an opportunity to garner more data and information on the subject. Utilities are already free to implement demand-side bidding if they believe such a program would be advantageous, of course.

A number of parties addressed the proper role of the Commission and its Staff in reviewing and providing oversight of a utility's CLM programs. Staff recommended formal Commission proceedings to promote a comprehensive review of each utility's demand-side strategy. Later, Staff expanded its recommendation to suggest that we should initiate formal review of both demand and supply-side resource plans. Currently, utilities file their long range resource plans with the Division of Economics and Finance and such plans are available there for public review. Although public hearings are not conducted, nor Commission approval granted or denied, our Staff reviews those long-range resource plans extensively. We believe the existing process is working well. We, therefore, will not mandate a comprehensive formal review of utilities' long-range resource plans. However, formal review and approval of CLM programs is appropriate at this juncture. Such proceedings may focus on each new program prior to its implementation, or involve periodic review of a utility's entire demand-side package. Each utility, after consulting with the Staff, should determine which process is more appropriate in its individual circumstance.

Finally, the more we have focused on the issues surrounding conservation and load management, the more it has become apparent that an information gap exists relating to this subject. Public interest in energy efficiency and conservation has been increasing, as is exhibited by the comments we received here. We therefore direct our Staff to survey the information currently available and identify what additional methods would aid the dissemination of appropriate data regarding CLM options.

Now, the Commission, having considered the record developed in this case, is of the opinion and finds that the rules for promotional allowances should be revised as set forth in Attachment A; Staff, utilities, consumers and third party CLM providers should aggressively pursue cost effective CLM programs; Staff should initiate a working group to identify the alternative approaches to estimating demand-side program cost effectiveness and submit an interim report to the Commission on or before July 31, 1992; Virginia Power should initiate a demand-side bidding program; and further, Staff should review the information available to consumers about conservation and identify possible methods of distribution in order to reach the largest number of consumers interested in energy efficiency and conservation. Accordingly,

IT IS ORDERED:

(1) That our rules on promotional allowances shall be, and hereby are, superseded by the rules set forth in Attachment A;

(2) That Staff shall organize a working group to develop recommendations on an appropriate cost/benefit method or methods to estimate the effectiveness of CLM programs and submit an interim report to the Commission on or before July 31, 1992;

(3) That Virginia Power shall develop an experimental demand-side bidding program and report the projected schedule for development and implementation on or before August 1, 1992;

(4) That utilities shall file formal applications for review of CLM programs as discussed herein; and

(5) That this case shall remain open for the filing of the required reports.

Commissioner Moore took no part in the decision in this case.

NOTE: A copy of the Regulation entitled "Rules Governing Utility Promotional Allowances" is on file and may be examined at the State Corporation Commission, Document Control Center, Jefferson Building, Floor B-1, Bank and Governor Streets, Richmond, Virginia.